Y2K Newsletter

MMillennium

Industry on Track, But Challenges Remain for Year 2000

In a Senate Banking subcommittee hearing March 18 on a General Accounting Office (GAO) review of Year 2000 preparedness, OTS came off reasonably well, according to GAO testimony. The GAO said it saw "mainly good things" in its audit of OTS' internal preparation and its efforts to get the thrift industry ready for the computer rollover. At the same time, however, the government watchdog said, OTS and the thrift industry, like the other federal banking regulators and the banking industry, face a monumental challenge in making sure financial institutions have adequate guidance in preparing for the Year 2000 and in providing a level of assurance that such guidance is being followed.

In her testimony, OTS Director Ellen Seidman said the agency has a battery of agency and interagency guidance, web page checklists and this newsletter, among other tools, to help the industry address the rollover. "We believe the combination of our examination efforts; our active outreach to, supervision and monitoring of the industry; and our own compliance efforts should minimize and contain problems involving either thrifts or the OTS when the calendar rolls over to the Year 2000," she said. "We are committed to making the Year 2000 conversion process as manageable as we can for our regulated institutions."

The hearing before Senator Robert Bennett of Utah was one of a series of hearings his subcommittee is holding to explore Year 2000 preparedness of the banking and thrift industries and credit unions. He said that OTS is ahead of the other agencies in its internal remediation. Ms. Seidman noted that OTS is moving to have its own mission critical systems in compliance by November 1998. Thirteen of 15 such systems already have been tested and are ready.

She pointed out that OTS examiners are conducting on-site examinations of all 1,200 thrifts regulated by OTS, a process due to finish by June 30, 1998. This round of examinations is focusing on renovation and conversion efforts. As of the hearing date, OTS had begun 337 examinations, and 231 had been completed. Out of that number, 199 had been rated and 77 percent received a "satisfactory" rating; 22 percent received a "needs improvement" rating; and two institutions were rated "unsatisfactory." It was explained further, however, that the early examinations focused primarily on institutions that had been judged high risk as a result of the off-site examinations conducted last year.

Second-round results will help the agency better assess each institution's actual renovation track record and prospects for timely completion of their efforts. "The objective of all the efforts by OTS is to get the thrift industry to the finish line," Ms. Seidman said.

Ms. Seidman especially emphasized the importance of institutions working together, for example, through user groups, to assess the progress of service providers and to arrange timely testing schedules.

The chief criticism of the GAO has been that the banking agencies and the National Credit Union Administration started late in addressing the Year 2000 problems. Ms. Seidman responded that while true, it is in the past, and the agencies now must focus on the future. She said OTS is assessing its resources to put them to work where they are most needed.

As for guidance, Ms. Seidman said OTS had just sent additional guidance to its regional offices to assist them in the second round of examinations. Included in the guidance were the three-grade rating system (satisfactory, needs improvement, unsatisfactory) and details on data collection, supervisory follow-up and enforcement actions. This guidance was followed by new information from the Federal Financial Institutions Examination Council (FFIEC) covering risks posed by service providers and software vendors and risks from customers of financial institutions, including funds providers. All the banking agencies cooperated in developing the FFIEC guidance.

The material on service providers and software vendors encourages institutions to develop a due diligence process to determine whether these entities are taking appropriate Year 2000 actions and to establish precise criteria for achieving compliance. The customer risk guidance is designed to help identify material customers, evaluate their Year 2000 preparedness and credit risks and to implement controls to manage risk. Additional guidance on testing and contingency planning is nearing completion. You should receive the testing guidance soon and the contingency planning guidance by the end of April.

President Signs Legislation Extending OTS Exam Powers

President Clinton, on March 20, signed into law the legislation giving OTS the statutory authority to examine service providers. Upon signing the bill, the White House issued the following statement:

"Today I am pleased to sign into law H.R. 3116, the 'Examination Parity and Year 2000 Readiness for Financial Institutions Act.' This legislation calls upon Federal financial regulatory agencies to conduct seminars and provide guidance for financial institutions on the implications of the Year 2000 problem. It also extends to the Office of Thrift Supervision and the National Credit Union Administration statutory authority, similar to that of the other Federal banking agencies, to examine the operations of contractors that perform services for thrifts and credit unions. These services include data processing and the maintenance of computer systems that are used to track everything from day-to-day deposit and loan activity to portfolio management.

"Many thrifts and credit unions, particularly smaller ones, rely heavily on the services of outside contractors for the processing of critical business applications. This legislation will assist Federal regulators in better understanding the Year 2000 risks to which thrifts and credit unions may be exposed and will bolster efforts to work with them to ensure that they will be able to continue to provide services to their customers without disruption.

"The Year 2000 problem is one of the great challenges of the Information Age in which we live. My Administration is committed to working with the Congress and the private sector, to ensure that we minimize Year 2000-related disruptions in the lives of the American people."

Beware of Alleged OTS Vendor Preferences

The agency has recently been asked whether it has put together a preferred service provider list. The emphatic answer is "No." Another misleading report is that OTS has found a service provider to be "65 percent complete" in its remediation efforts. First and foremost, OTS does not place vendors on preferred lists. Neither OTS nor any other FFIEC agency endorses particular service providers. A financial institution's primary regulator does, however, provide a copy of the report of examination prepared on a service provider to each institution that is a client of that servicer.

Second, any reference to a service provider's completion percentage on Year 2000 readiness is not meaningful in determining its compliance. Users must test the servicer's systems before that can happen. Thrift management must be involved in the testing process. At a minimum that means the vendor should provide a complete program to the user as to how testing will be done. Users should understand how the service provider plans to include them in the testing programs and, if user groups are to be used for various applications, which group will be testing their applications. Users should determine that the equipment and applications on which the test will be conducted are compatible with the users' equipment and applications. Progress reports should come from the user groups under an established time table to assure progress is being made in the provider's testing program.

Most importantly, the user must make certain the service provider is aware of the problem, has a plan in place, is executing it in a timely manner, and has a contingency plan in the event problems arise.

Conference Planned for June 2

John Koskinen, who chairs the President's Council on the Year 2000 Conversion, will be a featured speaker at a conference OTS and Chase Manhattan Bank will jointly sponsor in New York City on June 2. Koskinen, a former official of the Office of Management and Budget, is spearheading the government's own conversion efforts, as well as its efforts to maximize economy-wide attention to the problem. OTS' Northeast Region is working with Chase to organize the conference, which will focus on testing. Last May, OTS and Chase collaborated in a conference that attracted about 200 representatives of financial institutions and service providers. A like attendance is expected this year. This newsletter will provide more details in future issues.

Year 2000 Checklist Updated

The Year 2000 Checklist for organizing, planning and implementing renovation of computers and which is on the OTS web page has been updated. The original tasks in the checklist remain intact, but they have been reorganized to comply with FFIEC's five phases of preparedness – Awareness, Assessment, Renovation, Validation and Implementation.

An additional section has been added, entitled "Year 2000 External Risks & Operational Issues to Consider." These matters include reliance on vendors, data exchange, corporate customers, replacement versus repair, cost and monitoring, mergers and acquisitions, remote locations, contracts and leap year.

The Importance of Contingency Planning

So you have renovated your system; it's been tested and checks out just fine, and you are ready for the Year 2000 rollover. The date arrives, you turn on the system, and it doesn't work, or you encounter severe problems. Have you developed a contingency plan to get you through the rollover? A significant portion of attention being given to Year 2000 contingency planning has been focused to this point on the possibility of an institution switching its service provider(s), should it reach the point where it's believed the current service provider (s) will not achieve Y2K compliance by a certain time.

That strategy assumes that other service providers will be accepting new customers when the "date" arrives and that there will be sufficient time to make a conversion to another servicer. These assumptions are highly uncertain, given the widespread impact Year 2000 is having on businesses throughout the world. While back-up plans for switching service providers is perhaps one element of a well-developed contingency plan, it ignores what OTS believes may be the more significant issue – what do you do if the system doesn't work on Rollover Day, or problems arise.

This side of the Y2K issue deserves more attention. It poses some basic questions that need to be considered. For example, has your institution identified the human and monetary resource needs if you had to manually post transactions for an indefinite period? Do you have the supplies to adequately function that way? Has your staff been trained to deal with this scenario? Would you have to suspend the acceptance of new loan or deposit account applications? Have you considered your institution's liquidity needs if cash withdrawals temporarily increase? Do you have a structured manual accounting system for accurately documenting your customers' account activity: is your internal audit staff prepared for auditing such a system?

This list of questions should give you an idea of what might need to be addressed should your computer systems not be able to properly serve you on that first business day of the new millennium, particularly if your institution has a large volume of transaction activity requiring manual posting and accounting records. While the past and future resources that have been directed at the Y2K problem should significantly reduce the likelihood that widespread data processing problems will occur as the calendar rolls over, no one can be sure until it really happens. We believe a comprehensive contingency plan should cover the premise that manual data processing might be required, and for an extended period. Having a reasonable plan in place that your staff understands and is prepared to implement could save your institution significant aggravation.

A Quiz on Prudent Practices on Year 2000 Testing

OTS' Northeast Region has just completed a series of Year 2000 preparedness seminars for thrift representatives, focusing on the testing phase of the prep cycle. The region has developed a set of guidelines called "Prudent Practices," which are aimed at helping institutions through the testing phase. These practices are not regulatory requirements, but they are a further instrument thrift institutions may use to help prepare for the Year 2000 changeover.

The questions cover the computer system from the teller's terminal to the mainframe and back again. All key components of software and hardware must be tested, and the Prudent Practices are designed to help assure that proper testing is in place. Tri Ma Gia, Information Systems Manager for the Northeast Region, says the practices take the form of 30 questions organized around seven goals.

The goals are:

- Identify the Year 2000 ready date for all production systems.
- Verify the proper operation of all transactions and commands for all production systems for all key Y2K dates.
- Certify that all incoming and outgoing data files are Y2K compliant and properly processed by all systems.
- Verify that all value added systems properly operate in a Year 2000 environment and accurately handle all transactions and input and output data.
- Determine that all voice and data communication switches, devices and providers, including common carriers, will operate properly in a Year 2000 environment.
- Verify that the scope of testing includes both limited samples of data and transactions, as well as full-file tests for all data and transactions for all key Y2K dates.
- Assure that audit (internal or external) has verified the completeness of testing, the adequacy of sampling and the accuracy of results.

The 30 questions follow under 8 different headings.

Y2K ready date: when will packages and systems be compliant and ready for testing?

1. Have you identified the Y2K ready date for all in-house systems, all servicers and providers who send data to you, all servicers and providers to whom you send data, and all computer systems and hardware?

Transactions and commands - instructions and options for all computer systems, application systems, support programs, utility programs, and value-added systems.

2. Do you have a table of all transactions and commands for all production systems, and specifically how they have already been tested for compliance – with what options or features? The testing may be done in-house, by vendors, by user groups or others.
3. Have all transactions and commands for all production systems, all appropriate options, and features been tested using all the key Y2K dates? (See below)
4. Have you distributed the tables of transactions and commands for all systems to the appropriate business units for their certification that the testing in their specific area has been adequate?
5. Have you requested that the appropriate business units recommend supplemental transaction or command testing, including key Y2K dates, options and features? (See below)
6. Have you either performed the additional recommended testing yourself, or arranged for user group or vendor testing? Has the additional recommended testing been successfully completed and presented to business units for acceptance and verification?

Incoming data feeds – data files that are received at your system from other locations, service providers and customers.

7. Do you have a table of all known data feeds into your systems, including ACH wires, payroll, item processing, ATM, etc.? Are all known data feeds into your system Y2K ready, as certified by the provider of the data?
8. Have all of your systems received and successfully processed all known input data feeds in their Y2K compliant formats during their testing process?
9. Have all known input data feeds been tested using all the key Y2K dates? (see below)
10. Have you distributed the results for all known input data feed testing to the appropriate business units for their certification that testing in their specific area has been successful?

Outgoing data feed – data files that are created and sent from your system to other locations, service providers and customers.

11. Do you have a table of all known data feeds out of your system, including ACH, wires, payroll, balance files, etc.? Are all your systems prepared to create all Y2K compliant output data formats from all data feeds?
12. Have all systems tested sent all Y2K compliant output data feeds, and have those feeds been properly processed by the external sources.
13. Have all known output data feeds been tested using all the key Y2K dates? (See below)
14. Have you distributed the results for all known output data feed testing to the appropriate business units for their certification that testing in their specific area has been successful?

Value-added systems – systems that read and process your files for back office, customer support, operations, backup, or archival purposes – including voice response, automated fiche, optical disk archives, tape libraries and the like.

15. Have you identified all value-added systems? Has your vendor reviewed the Y2K compliance of each value-added system? Have you renovated or replaced any non-compliant value-added system, and tested the renovated or replaced system?
16. Do you have a table from all your vendors of vendor-tested transactions and commands, and specifically how they have already been tested for compliance, with what options or features, for all value-added systems?
17. Have all transactions and commands for value-added systems and all appropriate options and features been tested using all the key Y2K dates? (See below)
18. Have you tested each value-added system in a Year 2000 environment, including "booting" up with a Year 2000 date, and processing test data, including files that may have internal labels and headers with dates in them?
19. Have you tested each value-added system with test data having all key Y2K dates in the internal labels and headers? (See below)

Voice and data communications switches and devices; providers of business-critical utilities.

20. Have all telephone switches that service all your locations been reviewed for Year 2000 operations, including voice mail, and has each been test booted in a Year 2000 date environment to verify accurate operations, including voice mail?
21. Have all network routers and devices that service all your locations been reviewed by their vendors for accurate Year 2000 operations and has each been test booted in a Year 2000 date environment to verify accurate operations?
22. Have all network providers for voice and data lines been reviewed for Year 2000 operations?
23. Are independent assessments available for Year 2000 compliance for all network providers for voice and data lines?
24. Have all critical utility providers for electricity, backup power, satellite or cable service and all other facility support services been reviewed for Year 2000 operations?
25. Are independent assessments available for Year 2000 compliance for all critical utility providers for electricity, backup power, satellite or cable service and all other facility support services?

Scope of testing – limited and full file and limited and full transaction.

26. Has testing utilized a limited sample of transactions and command and data records for all key Y2K dates (See below), from all data sources including master files, local records, input data feeds and output data feeds?
27. Has testing utilized a full file test of transactions and commands and data records for all key Y2K dates (See below), from all data sources including master files, local records, input data feeds and output data feeds?
28. Has testing utilized all possible transactions and commands with all key Y2K dates?

Audit verification of testing, completeness of the scope, adequacy of sampling and accuracy of results.

29. Have auditors – internal or external – reviewed and accepted the adequacy and accuracy of the testing for transactions and commands, incoming data feeds, outgoing data feeds, value-added systems, voice and data communication networks and public utilities?
30. Have auditors reviewed and accepted the adequacy and accuracy of the testing for partial sampling and full file, full transaction testing?

Key Y2K Dates – testing should include most or all of these dates to ascertain that renovated systems operate successfully both in the 20th Century and in the 21st Century and handle leap years properly in all cases.

12/31/1899 - Use this date or any previous date to verify age and date of birth calculations.
02/29/1999 - Invalid leap year testing; any non-leap year would do.
09/09/1999 - Ensure that this is a valid date for application processing
12/15/1999 - Use this date to test to ensure everything behaves normally as we approach the Year 2000 and transactions that create future date calculations.
12/31/1999 - Ensure dates roll into next century.
01/01/2000 - Use this date to test processing for the first day of the year.
01/03/2000 - Validate first business day of the century.
02/29/2000 - Check leap year.
03/01/2000 - Check leap year.
03/31/2000 - Check end of quarter.
12/31/2000 - Validate processing for the last day of the year.
02/28/2001 - Ensure leap year properly handled in subsequent years.
02/29/2004 - Check leap year.
03/01/2004 - Check leap year.

TIP: One institution in the Midwest held an informal meeting for its borrowers, and brought in an outside expert to describe the problem and what needs to be done. In a Q&A session, institution representatives asked what the borrowers were doing in their businesses about the problem. It seemed a good way to enhance awareness of the problem and find out what large borrowers are doing to prepare for the Year 2000 rollover.

Following are the contacts in each of the OTS regions:

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